

## Summary of Testimony of

Terry J. Jorde

on behalf of

### INDEPENDENT COMMUNITY BANKERS OF AMERICA

#### Proposed Wal-Mart Bank's Application for Federal Deposit Insurance

April 10, 2006

ICBA urges the FDIC Board to deny Wal-Mart's application for federal deposit insurance. Wal-Mart's history suggests strongly that the company will expand into retail banking. However, even if it doesn't, the impact of Wal-Mart's entry into our nation's payments system is by itself reason enough to deny the application.

#### **Allowing Wal-Mart to own a bank would:**

- **Jeopardize the stability of the payments system by providing Wal-Mart with the capability to exert undue influence over the payments system.** It would pose significant systemic settlement and security risks to the payments system and its participants given Wal-Mart's dominant role in the global economy. Wal-Mart Bank would have to balance its responsibilities as a bank with the liquidity, profitability and business demands of its owner, which could insist that the Wal-Mart bank delay payments to or take other actions that add new risks to the payments system. And without Federal Reserve oversight of Wal-Mart, there is weakened regulatory protection to guard against this abuse. Wal-Mart Bank also could use its market dominance to require its suppliers to use its banking services as a condition of doing business, and this could extend to other banks, payments networks and payments processors.
- **Raise safety and soundness concerns and pose a threat to the bank insurance fund and the banking system.**
  - As the world's largest corporation, the sheer size of Wal-Mart not only poses a severe risk to the BIF, but it also presents very real systemic risks to the economy. Think what would have happened if Enron or WorldCom owned a bank, and those companies are dwarfed in size by Wal-Mart. With 70% of its goods produced in China, Wal-Mart faces risks that other banks, even other commercial firms, do not face. These risks should be avoided.
  - Wal-Mart, as the parent company, would not be subject to Federal Reserve supervision as are owners of other banks. Although the bank would be subject to FDIC oversight, the FDIC does not have the same powers to oversee the consolidated entity as does the Federal Reserve. A recent

GAO study found that inadequate authority to oversee and regulate ILC owners poses increase risks to the deposit insurance fund, and the Federal Reserve supports closing the ILC loophole by bringing ILCs under the BHCA.

- **Irreversibly change the fundamental structure of the American financial system by allowing the world's largest corporation to violate our nation's long-standing policy against the mixing of banking and commerce.** Federal Reserve Chairman Bernanke has voiced serious concerns about breaching the banking and commerce wall. Allowing Wal-Mart to own a bank would produce an excessive concentration of economic power, jeopardize the impartial allocation of credit, and extend the federal safety net beyond congressional intent.
- **Threaten to destabilize local communities through disinvestment, disintermediation and market domination.** A Wal-Mart bank would not serve the convenience and needs of the community. Credit decisions could be skewed because of competitive considerations, as the Wal-Mart bank would have an incentive to favor Wal-Mart's suppliers and disfavor their competitors. Impartial allocation of credit, the triumph of our economic system, would be lost. A Wal-Mart bank would also likely export deposits out of the local community, depriving the community of funds for local lending, economic development, and municipal projects, and exacerbating local small businesses funding challenges. If community banks are driven out of business, the community would lose a valuable stakeholder and civic leader.

**In addition, the FDIC Board should weigh carefully whether the character and fitness of Wal-Mart's management is adequate to ensure the safe and sound operation of a financial institution under its control.** Wal-Mart is one of the most frequently sued companies in history – reportedly, 4,851 times in 2000 alone. A group of investors stated that they were “deeply concerned about contingent liabilities and negative effects on the company's stock price and reputation.” The investors added the frequency of “non-compliance with internal standards, as well as with laws and regulation, may be far too commonplace at Wal-Mart.”

**Conclusion.** The application by Wal-Mart Bank for federal deposit insurance coverage fails to satisfy all the factors the FDIC Board must consider in evaluating the application. Therefore, the application should be denied. Moreover, there is a viable alternative to a Wal-Mart Bank, and that is partnering with local banks that lease space and operate branches within their stores. There is no clear public policy justification or increased social benefit to local businesses and consumers in allowing Wal-Mart to control banking establishments.



**Testimony  
of  
Terry J. Jorde  
President/CEO of CountryBank USA**

**on behalf of the**

**Independent Community Bankers of America  
Washington, DC**

**“Public Hearing on the Proposed Wal-Mart Bank’s  
Application for Federal Deposit Insurance”**

**Federal Deposit Insurance Corporation**

**April 10, 2006**

Good morning. My name is Terry Jorde, President and CEO of CountryBank USA, in Cando North Dakota. I am also Chairman of the Independent Community Bankers of America.<sup>1</sup> On behalf of the 5,000 members of ICBA, I would like to thank FDIC Acting Chairman Gruenberg and the entire FDIC Board for scheduling these public hearings on Wal-Mart Bank's application for deposit insurance for a proposed Utah-based industrial loan corporation (ILC). And thank you, Officer Bovenzi, for presiding over this important and timely hearing on a matter of enormous potential consequence for our nation's financial and economic system, and local communities across the country. I appreciate the opportunity to express our views before this panel.

ICBA and the nation's community bankers strongly oppose Wal-Mart's deposit insurance application and we urge the FDIC to reject it. The swell of opposition to this application is growing from every quarter. Notably, well over 100 members of Congress have expressed their strong concerns and reservations to the FDIC about this application and urge that it be denied.

### **The Application Should Be Denied; Summary of Risks and Concerns**

Wal-Mart Bank's application presents grave implications and critically important public policy concerns that the FDIC Board must carefully and thoughtfully consider before acting on the application. For the following reasons, we strongly urge the FDIC to deny the application.

Allowing Wal-Mart, the world's largest corporation, to own a bank:

- raises safety and soundness concerns and poses a threat to the bank insurance fund and the banking system itself because of inadequate authority to oversee and regulate the parent company;
- jeopardizes the stability of the payments system, around which our free market economy functions;
- threatens to destabilize local communities through disinvestment, disintermediation and market domination; and
- could irreversibly change the fundamental structure of the American financial system and economy by allowing the world's largest corporation to violate our nation's long-standing policy against the mixing of banking and commerce.

In addition, the FDIC Board should think carefully before allowing a company that has a long history of legal and regulatory non-compliance into the banking business.

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<sup>1</sup> The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

Community bank opposition to Wal-Mart's entry into banking has been challenged, first, as an over-reaction because Wal-Mart has no interest in expanding into retail banking operations, and second, as based on community bank fear of competition. Yet Wal-Mart has established a history of repeated attempts to enter into retail banking and has publicly expressed the desire to do so. Community banks do not fear fair competition. In fact, community banks compete with 12,000 financial institutions every day. This testimony will address these issues in further detail, as well as the other public policy issues involved.

## **History of ICBA Involvement**

ICBA has a long history of leading the fight to maintain the separation of banking and commerce and to keep Wal-Mart out of banking. In 1999, when Wal-Mart first attempted to gain a foothold in banking by exploiting the unitary thrift loophole, ICBA fought hard to close the loophole, which allowed commercial companies to own FDIC-insured institutions, in the Gramm-Leach-Bliley Act. In fact, we held this position long before Wal-Mart applied to acquire a small Oklahoma thrift institution. We have opposed each succeeding attempt by Wal-Mart to enter the banking business.

ICBA's history of opposing the concentration of financial assets is rooted in our Articles of Incorporation, which state that a guiding aim and principle of ICBA is to "oppose the concentration of control of financial services resources." One key aspect of this principle is maintaining the separation of banking and commerce. This issue is central to the mission of our association and crucial to maintaining the strength and stability of our nation's financial and economic system, including community banks.

## **A Wal-Mart Bank Would Threaten the Payments System**

Wal-Mart has submitted a business plan for the ILC that is narrowly drawn to provide back office processing of credit card, debit card and electronic check transactions in Wal-Mart stores.

We contend that even this narrow business plan poses potential dangers to our nation's payments system severe enough to warrant a rejection of this application. Recently, 45 members of Congress in a bipartisan letter to the FDIC warned of the payment system risks and concerns presented by Wal-Mart's bank application.

A Wal-Mart bank would provide Wal-Mart with the capability to exert undue influence on the payments system through its suppliers to the detriment of other participants. A Wal-Mart bank would pose significant systemic settlement and security risks to the payments system and its participants given Wal-Mart's dominant role in the global economy.

Banks play a central role in the payments system. The Wal-Mart Bank proposes to process the hundreds of millions of payments its customers make in Wal-Mart stores. These customers pay with checks and cards issued by just about every bank in the country. Currently, fully regulated

banks do this work for Wal-Mart.

While companies other than banks may help stores and banks process check and card transactions, only banks can actually transfer funds from one party to another, known as settlement. Federal supervisors make sure that banks follow stringent policies and procedures to manage the risks involved in clearing and settling payments transactions and have adequate capital. These risks include fraud and potential insolvency of those who are making and accepting payments, and those who are clearing and settling them.

#### Market Dominance, Systemic Risk

Given Wal-Mart's retail dominance, the Wal-Mart Bank would quickly become a major participant in the global payments system. Wal-Mart stores accept 140 million electronic transactions a month. The Wal-Mart Bank would process over \$170 billion per year. This does not include the transfer of funds to Wal-Mart suppliers.

The Wal-Mart Bank would have to balance its responsibilities as a federally-insured bank with the liquidity, profitability and business demands of its owner. Wal-Mart, the holding company, could insist that the Wal-Mart Bank delay payments to or take other actions that add new risks to the payments system. The Wal-Mart Bank's failure to timely settle payment transactions could harm thousands of other financial institutions and their customers. Since the owners of ILCs are exempt from Federal Reserve oversight, there is weakened regulatory protection to effectively guard against this abuse.

#### Payments System Powerhouse

Once the Wal-Mart Bank establishes its hold in the payments system, it could easily expand by offering its payments clearing services to other businesses of all sizes, increasing its role in the payments system and increasing concentration and risk. Wal-Mart's subsidiary, Sam's Clubs, already offers a myriad of products to small- and medium-size businesses. Sam's Clubs could easily offer its customers payment services from the Wal-Mart Bank.

Particularly troubling, Wal-Mart could use its extraordinary market clout to require that its suppliers use its banking services as a condition of doing business with Wal-Mart. Wal-Mart has a well-established, heavy-handed reputation for dealing with its suppliers. Basically, it's the Wal-Mart way or no way. If a business sells a significant percentage of its products to Wal-Mart, as many suppliers do, it would have little choice but to bank with Wal-Mart.

Once established, the Wal-Mart Bank would also be ideally positioned to exert undue influence on other banks, payments networks and payments processors to obtain the lowest pricing possible and to create rules to its advantage. Moreover, given its sheer dominance, the Wal-Mart Bank could decide to game payments rules it did not like. This could damage other stakeholders and upset the equilibrium of the payments system. Without effective regulation and supervision of Wal-Mart, the judicial system is the only recourse for addressing this undue influence. Wal-Mart has the financial resources to delay any litigation to the point where the harmed entities would no longer be in business.

Finally, a Wal-Mart bank would signal a paradigm shift in the payments industry. To stay competitive, other retailers would have to follow suit. In a retailer-driven payments environment, seeking competitive advantage, rather than risk mitigation, would be the driving force. Consumers, small businesses, and banks of all sizes would be the victims if risk mitigation policies become secondary to market share.

#### Capital Adequacy

The scope and potential expansion of Wal-Mart's payments system operations also raises questions about the level of capital that it should be required to hold to guard against loss. Wal-Mart Bank's asset size, which its application projects to be less than \$30 million during the first three years of operation, will mask the true risk posed by the bank. Large scale operational and settlement risk flowing from its hundreds of billions of payments each year will be the main concern, not credit risk represented on its balance sheet. In fact, the bank will clear twenty times or more the dollar value of its assets in payments transactions each day just from the Wal-Mart stores.

#### Tip of the Iceberg

Given the systemic risk, potential for conflicts of interest, and undue market concentration a Wal-Mart bank brings to the payments system, Wal-Mart should not be granted a banking charter for payment system risk alone. However, history suggests that Wal-Mart will not be satisfied with a second-story operation to manage its debit, credit and electronic payments transactions.

### **Wal-Mart's Ongoing Campaign to Enter the Banking Business**

Wal-Mart does nothing on a small scale. We respectfully suggest that Wal-Mart's recent history belies the assertions made in its narrow application, justifying our skepticism that Wal-Mart will honor the business plan as filed for very long. This application to exploit the ILC loophole would give Wal-Mart an irreversible toehold into the banking system.

The application to charter an ILC in Utah represents Wal-Mart's fourth attempt in recent years to enter the banking business. Indeed, Wal-Mart has embarked on a well-publicized mission to get into the banking business despite existing legal and regulatory barriers established on long-held public policy grounds to prevent the full-blown mixing of banking and commerce. Each previous attempt was thwarted by concerned bank regulators and lawmakers. The FDIC Board should carefully consider the history of Wal-Mart in this area in the context of stated management goals with regard to growth and product lines.

#### Broken Arrow Savings and Loan

Wal-Mart's first attempt to enter the banking business was in 1999 when the company tried to exploit the "unitary thrift holding company loophole" with an application to acquire Broken Arrow S&L, a small Oklahoma thrift institution. Until 1999, unitary thrift holding companies could own, or be owned by, commercial firms. Congress thwarted Wal-Mart's plans and closed this loophole when it passed the Gramm-Leach-Bliley Act of 1999, and the crucial firewall

between banking and commerce was protected. To ensure Wal-Mart's application would be rejected, Congress banned the acquisition by commercial companies of unitary thrift institutions after May 4, 1999. Wal-Mart had missed this deadline and its application was denied.

#### Toronto-Dominion Bank USA

In September, 2001, Wal-Mart attempted to enter the banking business by partnering with Toronto-Dominion Bank USA, to initially offer banking services in some 100 Wal-Mart stores. Wal-Mart even planned to use its retail store employees to perform banking transactions for TD Bank in their stores. This time, Wal-Mart's plan to enter retail banking was blocked by the Office of Thrift Supervision (OTS). In what then-OTS Director Ellen Seidman said was "the shortest letter we've ever written," the OTS dismissed the Wal-Mart-TD Bank arrangement. The OTS's letter stated that the agreements and plans outlined in the application appeared to give "Wal-Mart illegal control over TD Bank USA and would therefore be deemed a savings and loan holding company. Second, it appears that the proposal is a circumvention of...the Home Owners Loan Act, which prevents a company engaged in commercial activities from becoming a savings and loan holding company." In light of the OTS's scrutiny, Wal-Mart and TD Bank were forced to withdraw their application.

#### Franklin Bank of California

In 2003, Wal-Mart attempted to acquire Franklin Bank, a California industrial loan corporation. Owning an ILC charter in California not only would have given Wal-Mart Bank entry into one of our nation's largest and most lucrative markets, but it would have enabled Wal-Mart Bank to launch retail banking operations in other states as well. After a protracted battle in the state legislature, California lawmakers passed an ICBA-backed law prohibiting commercial firms from owning California ILCs, effectively blocking Wal-Mart's acquisition attempt. ICBA and the California Independent Bankers testified in California in support of that law.

The application to charter an ILC in Utah is but the latest chapter in Wal-Mart's long history of trying to get into the banking business.

#### Wal-Mart CEO Eyes Financial Services

In addition to Wal-Mart's history of trying to get into banking, Wal-Mart's CEO stated publicly that the company's next major growth area is financial services, adding credibility to our skepticism that Wal-Mart's banking interest is narrowly focused. In an interview<sup>2</sup> with a reporter for the Los Angeles Times who asked what new products or services Wal-Mart could add, CEO H. Lee Scott, Jr., said, "Well, I think financial services is one we would like to be in. We're already offering money orders. We've dramatically lowered the costs of wiring money. There's probably a place for us in mortgages. I think the dot-com is going to be a very powerful tool."

This is in stark contrast to Wal-Mart's assertion that it is only interested in narrow financial services to support its payment operations.

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<sup>2</sup> "The Wal-Mart Effect," *Los Angeles Times*, Nov. 23, 2003.



CEO Scott also suggested that the company was looking to grow dramatically in future years. In response to a question regarding how large Wal-Mart can be, Scott said: “We are 8 percent of the nonautomotive, nonrestaurant sales in the U.S. I’m not sure why it couldn’t be 24 percent.” He added: “Is it really unhealthy for us to be 32 percent? Could we be four times bigger right here? I don’t know why not.”

Wal-Mart has hinted in the past that it would like to control 20% of every retail sector that it is in. The statements by Mr. Scott suggest an even more ambitious growth plan that includes financial services.

### **Community Banks and Competition**

The assertion that community bankers oppose the Wal-Mart application simply because they are afraid of competition is absurd. Community bankers welcome competition. Community bankers compete with thousands of other community banks, large regional and nationwide banks, tax-subsidized credit unions and farm credit associations, securities firms and equity dealers, mortgage brokers and real estate companies, non-regulated finance companies and payday lenders, the local post office and Western Union, and the list goes on. Community bankers not only welcome competition, we thrive on it. Healthy and fair competition stimulates the development of new product and service lines that not only help our bottom line, but create real value for our customers. To suggest that community bankers are afraid of competition is uninformed, unwarranted, and only diverts attention away from the real policy issues.

Our primary concern is that Wal-Mart has the size and resources to engage in predatory pricing for as long as it takes to drive local competitors out of the market – not only community banks, but other locally-owned small businesses as well. A community bank is only as strong as the community it serves. If our small business customers are driven out of business, our deposit base will suffer, our earning assets will decline, and the level of resources available for capital development and community lending will deteriorate.

Small businesses, including community banks, bring value to a community through local ownership, hands-on knowledge of the community and a stakeholder commitment to the community. Small business owners not only volunteer hundreds of hours a year to serve on school and hospital boards and other civic organizations, but we also donate many thousands of dollars every year to civic causes. We do this because we live in the community, take pride in the community, and have a financial stake in the community. We stay with the community in good times and in bad. Our concern is that the Bentonville, Arkansas-based owners of Wal-Mart will not share in this commitment, as has been demonstrated in community after community where Wal-Mart stores shut down when the bottom line got too small. Various retail outlets competing with Wal-Mart have charged that it engages in predatory pricing practices to capture market share, then raises prices once competitors are eliminated. If the bottom line gets too

small, they abandon the community.<sup>3</sup> Locally-owned businesses do not abandon their communities when the times get tough.

## **Maintaining the Separation of Banking and Commerce**

Allowing Wal-Mart to own a bank violates this nation's long-standing policy of keeping banking and commercial interests separate, the linchpin of the financial and economic system of the United States. This tradition has resulted in the most vibrant, successful and diversified economic and financial system in the world. The essential walls separating banking and commerce prevent conflicts of interest and undue concentration of resources, and ensure the impartial allocation of credit so vital to economic growth and development and to a safe and sound financial system.

On November 4, 1999, 362 members of the U.S. House of Representatives and 90 members of the Senate voted to reaffirm our national policy of maintaining the separation of banking and commerce by voting for the Gramm-Leach-Bliley Act (S. 900). The Act closed the unitary thrift holding company loophole, which was increasingly jeopardizing the separation of banking and commerce by allowing unitary thrift holding companies to own or be owned by commercial firms.

This was not a close call for the legislative branch. Nor were there any dissenters in the executive branch. In congressional testimony, then-Treasury Secretary Robert Rubin warned the Senate Banking Committee that not closing this loophole would "allow a dramatically expanded mixture of banking and commerce...[and] we would have serious concerns about these mixtures." That same concern was echoed by Chairman of the Federal Reserve Board Alan Greenspan who stated in his testimony before the Senate Banking Committee:

"In light of the dangers of mixing banking and commerce, the [Federal Reserve] Board supports elimination of the unitary thrift loophole, which currently allows any type of commercial firm to control a federally insured institution. Failure to close this loophole now would allow the conflicts inherent in banking and commerce combinations to further develop in our economy and complicate efforts to create a fair and level playing field for all financial service providers."

Furthermore, then-House Banking Committee Chairman Jim Leach (R-Iowa), a key drafter and namesake of the sweeping 1999 GLB financial services reform act, stated at the time that without closing the unitary thrift loophole, he would have "done everything in my power to pull the plug on the bill."

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<sup>3</sup> See, e.g., When Wal-Mart Pulls Out, What's Left?, *New York Times*, March 5, 1995; Store Shuts Doors on Texas Town; Economic Blow for Community, *USA Today*, October 11, 1990; Arrival of Discounter Tears Civic Fabric of Small-Town Life, *Wall Street Journal*, April 14, 1987.

More recently, Federal Reserve Chairman Ben S. Bernanke, in response to a question posed by Rep. Brad Sherman, wrote: “The question of whether, or to what extent, the mixing of banking and commerce should be permitted...has important ramifications for the structure of the American financial system and the economy, particularly because any widespread combinations of banking and commerce likely would be irreversible.”<sup>4</sup>

The separation of banking and commerce is well founded and rooted in U.S. banking law. It has contributed to the greatest economy this world has ever known. This policy must be preserved. Despite the dramatic changes that have taken place in the delivery of financial services in the U.S. over the last several decades, lawmakers and regulators have recognized that the potential for conflicts of interest when banking and commerce are intermingled have not diminished. The need to keep banking and commerce separate remains essential. Concentration by a few industrial-retail giants in banking services is exactly the type of monopolistic and anticompetitive structures lawmakers have repeatedly prevented. The impartial allocation of capital and credit in this nation is the underpinning for our stable and highly successful economic and financial system.

#### Excessive Concentration of Economic Power

Separating banking and commercial interests guards against excessive concentration of economic power. Wal-Mart is the largest corporation in the world, with nearly \$300 billion in annual revenue, 3,600 domestic retail locations, 1.25 million U.S. employees, and more than 100 million customers a week. The sheer size of Wal-Mart not only poses a severe risk to the Bank Insurance Fund, it also presents very real systemic risks to our national economy. Tom Rubel, CEO of consultant Retail Forward Inc. warned that, “If [Wal-Mart] ever stumbles, we’ve got a potential national security problem on our hands. They touch almost everything. . . . If they ever really went into a tailspin, the dislocation would be significant and traumatic.”<sup>5</sup>

Wal-Mart faces risks that other banks, and even other commercial firms, do not face. For example, since 70% of the products sold in Wal-Mart stores are produced in China, Wal-Mart faces financial risks due to currency fluctuations and the volatile transportation and fuels market. Wal-Mart has become China’s most important trading partner, and if Wal-Mart were a country, it would rank as China’s eight largest trading partner, ahead of Russia, Australia and Canada. Notably, Wal-Mart’s business model looks to expand its retail operation in China to surpass even its mammoth U.S. operations. Wal-Mart’s systemic risk to the financial and payment system is likewise expanded globally to encompass the actions of other countries and political, currency and monetary systems.

Enron and WorldCom were dwarfed in size by Wal-Mart, but think of what might have happened if Enron or WorldCom owned a bank and involved the bank to help the company recover from financial difficulties or if the company’s troubles otherwise spilled over to destabilize the bank. This kind of economic power should be avoided.

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<sup>4</sup> Letter from Federal Reserve Board Chairman Ben Bernanke to Rep. Brad Sherman, March 21, 2006

<sup>5</sup> Business Week, *Is Wal-Mart Too Powerful?* Oct. 6, 2003.

### Extension of Federal Safety Net

Former Federal Reserve Chairman Alan Greenspan has repeatedly argued that the mixing of banking and commerce presents safety and soundness concerns and that the federal safety net protecting depositors of insured institutions will spread to non-depository affiliates, thereby introducing additional risks to the deposit insurance funds and putting taxpayer dollars at risk.

### Kieretzu Experiment

The negative experiences and economic consequences witnessed in a number of European and Asian countries are testament to the harmful and destabilizing effects of mixing banking and commerce. One can observe the ongoing strife in Japan's financial sector and economy where the dangerous mixing of banking and commerce, with the largest commercial companies and banks closely intermingled ("kieretzu"), was commonplace and a primary factor in the financial sector's ongoing predicament, and is now severely restricted. Kieretzu arrangements in Japan contributed significantly to a 15-year recession from which the country is just now emerging.

### Risks to BIF and Banking System

Because of these extraordinary risks, a Wal-Mart Bank would pose severe risks to the Bank Insurance Fund and to the banking system itself. Failure of Wal-Mart Bank or its parent company would produce staggering losses to the FDIC fund and pose catastrophic systemic risks to our economy. The FDIC Board should carefully consider whether or not the size of Wal-Mart and its global reach poses extraordinary risks to the deposit insurance fund and to the banking system that outweigh the value such an institution would bring to the marketplace.

## **ILCs Are Exempt from Consolidated Supervision**

Wal-Mart, as the parent of Wal-Mart Bank, would not be subject to Federal Reserve supervision, as are owners of other banks (bank holding companies). Although the bank would be subject to FDIC oversight, the FDIC does not have the same powers to oversee the consolidated entity as does the Federal Reserve. Without regulatory scrutiny, Wal-Mart could enter into financial arrangements that put the solvency of the bank and parent at risk.

For example, the Federal Reserve can establish consolidated capital requirements to ensure that bank owners are a source of financial strength. Wal-Mart would not be subject to such requirements. The Federal Reserve also has broad authorities over bank holding companies to require actions if the ownership poses a risk to the bank. Wal-Mart would not be subject to such authorities.

### GAO Study

A Government Accountability Office (GAO) report<sup>6</sup> on ILCs released September 22, 2005, found that the hybrid financial charters are not adequately regulated and pose increased risks to the deposit insurance fund. GAO called on Congress to close the regulatory gap between ILCs and commercial banks, and urged Congress to consider the risks inherent in allowing ILCs to be owned by commercial firms.

The GAO report noted the significant asset growth and evolution of ILCs from one-time small, limited purpose institutions to a diverse industry. Between 1987 and 2004, ILC assets grew exponentially by over 3,500 percent from \$3.8 billion to over \$140 billion.

GAO found that even though FDIC examines and supervises insured ILCs, “it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies [i.e., the Federal Reserve and the OTS].” The report continued, “these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company,” adding that, “Congress should consider strengthening the regulatory oversight accorded to ILCs.”

The FDIC Board should carefully consider whether the risk of additional loss to the bank insurance fund outweighs the benefits of maintaining a parallel, but more lightly regulated, financial structure.

GAO also raised concerns about mixing banking and commerce when ILCs are owned by commercial firms (ILCs are exempt from the Bank Holding Company Act, which prohibits commercial companies from owning banks). The GAO said it finds “it unusual that a limited ILC exemption would be the primary means for mixing banking and commerce on a broader scale and sees merits in Congress taking a broader look at allowing ILCs or other entities to engage in this level of activity.”

### Federal Reserve Raises Concerns

In his last official communication to Congress, former Federal Reserve Chairman Alan Greenspan raised serious concerns about allowing companies like Wal-Mart to breach the banking and commerce wall, and endorsed legislation introduced by Rep. Jim Leach to close the ILC loophole. Greenspan wrote:

“The character, powers and ownership of ILCs have changed materially since Congress first enacted the ILC exemption. These changes are undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of other full-service banks. Importantly, these changes also threaten to remove Congress’ ability to determine the direction of our nation’s financial system with regard to the mixing of banking and commerce and the appropriate framework of prudential supervision. These are crucial decisions. . . they should not be made through the

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<sup>6</sup> “Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority,” Government Accountability Office, GAO-05-621, Sept. 2005.

expansion and exploitation of a loophole that is available to only one type of institution chartered in a handful of states.”<sup>7</sup>

In remarks to ICBA’s 2006 National Convention and Techworld, current Fed Chairman Ben S. Bernanke reinforced Dr. Greenspan’s position on this issue.

“In the case of an ILC, the FDIC can supervise the bank but it has no powers and nor does anyone else to supervise the company that owns the ILC. The GAO has issued a report suggesting that failure to supervise the owner of an ILC leads to risks to the deposit insurance fund and to safety and soundness and we think it would be a good idea to move towards policies that eliminate that problem and make sure that if there is ownership of an ILC that there be consolidated supervision so that the owner as well as the ILC itself fall under the limitations, and activities fall under the supervisory requirements that other owners of banks will face.”<sup>8</sup>

### **A Wal-Mart Bank Would Not Serve the Convenience and Needs of the Community**

#### Impartial Credit Decisions Lost

Separating banking and commercial interests ensures the impartial allocation of credit, protecting the economy against conflicts of interest, and from credit being approved for competitive reasons, not because of the creditworthiness of the borrower. As a nationwide operation, will Wal-Mart-controlled local deposits be shifted to venues outside the community? Will a local hardware or clothing store, a local pharmacy, or someone wishing to establish a new store, be able to obtain credit from the Wal-Mart bank? The Wal-Mart bank would have no incentive -- in fact it would have a disincentive -- to lend to businesses that compete with its parent company. Instead of making impartial credit decisions based on the creditworthiness of the borrower, the Wal-Mart Bank would have incentive to deny credit, not on the merits, but because of a conflict of interest and its relationship with Wal-Mart. At minimum, Wal-Mart Bank could impose injurious credit terms and conditions that could impact the competitiveness of the new entity.

Ownership by Wal-Mart would have a similar effect on the bank’s decision-making with regard to credit applications by Wal-Mart suppliers. Again, instead of making credit decisions on the merits of a borrower’s creditworthiness, the Wal-Mart bank would have an incentive to favor Wal-Mart’s suppliers and disfavor their competitors. Impartial allocation of credit, the triumph of our economic system, could be severely damaged.

#### Deposits Would Not Stay in Community

Given the broad ability to collect deposits, whether through a branch network or through the

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<sup>7</sup> Letter from Federal Reserve Chairman Alan Greenspan to Rep. James A. Leach, January 20, 2006.

<sup>8</sup> Response to question following speech to ICBA National Convention and Techworld 2006, Las Vegas, Nevada, March 8, 2006

Internet or other non-branch marketing strategy, there is the genuine danger that Wal-Mart Bank will export deposits out of the local community. This has been the current pattern of the large retailer when it establishes itself in a local community. The retailer's deposits do not stay with local banks, but rather are wired overnight to the store's central headquarters and even used for its vast global expansion plans. In the past, this pattern has had a devastating effect on local communities as retail dollars spent in the community are exported elsewhere and do not remain in the community to support local lending and economic development.

The industrial bank charter would allow Wal-Mart to gain deposits by offering certificates of deposits (CDs) and NOW accounts. Additionally, legislative attempts are underway in the U.S. Congress to expand the industrial bank charter's bank powers so they can accept demand deposits, in essence giving them full banking powers. Unlike local banks that use their deposits for local lending, deposits collected by an international commercial operation like Wal-Mart could be easily exported outside the local community in which they are collected. Would other banks survive to offer alternative sources of local credit?

A study conducted by the Federal Reserve Bank of Kansas City<sup>9</sup> found that community bank funding challenges present a persistent, long-term problem that if not addressed, will "eventually force them to curtail lending to small businesses, farmers, and other local customers – many of whom may have few other places to turn to for their borrowing needs." Wal-Mart's potential exportation of deposits and capital out of a community will exacerbate local small business funding challenges.

The FDIC Board should carefully consider whether the convenience and needs of the community are served when credit decisions are skewed because of competitive considerations and local deposits are exported outside the community, creating a funding and investment vacuum that hurts consumers, small businesses, and municipalities alike.

### **Lawsuits Raise Questions, Potential Liability**

Wal-Mart is one of the most frequently sued companies in history. Wal-Mart was reportedly sued 4,851 times in 2000 alone -- that's once every two hours, every day, 365 days a year.<sup>10</sup> In addition to raising questions about the managerial competence and ethical standards of the company, this creates enormous potential legal liability for the company that could have an effect on future earnings and operations.

Wal-Mart's alleged violations of law and regulation range from labor and wage and hour violations including alleged discrimination in employment, to violations of environmental laws including the Clean Water Act, to violations of immigration laws.

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<sup>9</sup> "The Decline in Core Deposits: What Can Banks Do?" by James Harvey and Kenneth Spong, The Federal Reserve Bank of Kansas City, published in Financial Industry Perspectives 2001.

<sup>10</sup> Richard Willing, *Lawsuits a Volume Business at Wal-Mart*, USA Today, August 13, 2001

In May, 2005, a group of institutional investors holding more than \$545 million in Wal-Mart stock voiced concerns about an apparent breakdown in the company's legal and regulatory controls. The group, which includes William C. Thompson, Jr., the comptroller of New York City, stated that they were "deeply concerned about contingent liabilities and negative effects on the company's stock price and reputation," and urged the company to establish a special committee of independent directors to review and report on the company's legal and regulatory controls.<sup>11</sup>

Notably, the shareholders warned the company that "recent reports of legal and regulatory non-compliance raise serious concerns about the adequacy of the company's controls," and that, "the frequency of the reports suggests that non-compliance with internal standards, as well as with laws and regulation, may be far too commonplace at Wal-Mart."

The FDIC Board should weigh carefully whether the character and fitness of Wal-Mart's management is adequate to ensure the safe and sound operation of a financial institution under its control, and whether the future earnings of Wal-Mart Bank could be affected by the potential liability to the company triggered by the preponderance of outstanding lawsuits.

## **Conclusion**

ICBA believes that the application by Wal-Mart Bank for federal deposit insurance coverage fails to satisfy all the factors the FDIC Board must consider in evaluating this application. Therefore, the application should be denied. The public policy implications and risks addressed in our testimony far outweigh, in our view, any benefit a Wal-Mart Bank would bring to the community.

Moreover, there is a viable alternative to a Wal-Mart Bank. Simply stated, if Wal-Mart wants to provide retail banking services to its customers without breaching the banking and commerce restrictions or presenting undue risks to the system, it can and does so simply by partnering with hundreds of local banks that lease space and operate branches within their stores. Therefore, there is no clear public policy justification or increased social benefit to local businesses and consumers in allowing Wal-Mart to control banking establishments or to break the long-held and successful public policy of keeping banking and commerce separate and the payments system safe and secure. We urge the FDIC to deny Wal-Mart's application.

Thank you for the opportunity to present the views of our nation's community banks.

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<sup>11</sup> Letter from William C. Thompson, Jr., Comptroller, The City of New York, *et. al.*, to Roland A. Hernandez, Chair, Audit Committee of the Board of Directors, Wal-Mart Stores, Inc., May 25, 2005